

## Message Text

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ACTION NEA-10

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E.O. 11652: N/A

TAGS: EFIN, IN

SUBJECT: RECENT PRICE INCREASES CONCERN GOI

1. SUMMARY. PRICES HAVE BEEN RISING SINCE MID-MARCH 1976, PARTLY BECAUSE OF INCREASED MONEY SUPPLY. THERE HAS BEEN A SIGNIFICANT PRICE RISE BEGINNING THE SECOND WEEK OF JUNE DUE PRIMARILY TO HIGHER PRICES OF COTTON, VEGETABLE OIL AND SUGAR. A JULY 15 MEETING OF HIGH LEVEL GOI ECONOMIC OFFICIALS IS EXPECTED TO MAKE ANTI-INFLATIONARY RECOMMENDATIONS TO MRS. GANDHI. AN IMPORTANT MINISTRY OF FINANCE OFFICIAL TOLD EMBOFFS HE THOUGH A 5-6 PERCENT PRICE RISE THIS FISCAL YEAR WAS HEALTHY FOR AN EXPANDING ECONOMY AND THAT POLITICAL LEADERS WERE UNREALISTIC IN TRYING TO HOLD THE INFLATION RATE TO ZERO. END SUMMARY

2. WHOLESALE PRICES REACHED THEIR LOW POINT IN MID-MARCH 1976. BETWEEN THEN AND THE END OF JUNE -- A TIME WHEN PRICES USUALLY RISE--THE OFFICIAL WHOLESALE PRICE INDEX INCREASED BY 6.7

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PERCENT. (THE ECONOMIC TIMES WHOLESALE PRICE INDEX ROSE

BY ALMOST 10 PERCENT IN THE SAME PERIOD, BUT IT IS CONSIDERED TO BE LESS RELIABLE BECAUSE IT COVERS LESS GOODS.) THE PRICES OF FOOD ITEMS, AS MEASURED BY THE OFFICIAL INDEX, HAVE BEEN GENERALLY INCREASING AT A FASTER PACE THAN OTHER GOODS SINCE MID-MARCH.

3. ONE MAJOR REASON FOR THE CHANGED PRICE SITUATION HAS BEEN A RISING MONEY SUPPLY. IN MID-JUNE 1976 THE MONEY SUPPLY HAD INCREASED BY ALMOST 12 PERCENT OVER THE PREVIOUS TWELVE MONTHS (COMPARED TO A 9.6 PERCENT RISE IN IFY 1975-76.) BETWEEN MID-MARCH AND MID-JUNE 1976 THE MONEY SUPPLY HAS RISEN SHARPLY BY OVER SEVEN PERCENT. BANK CREDIT TO THE COMMERCIAL SECTOR HAS INCREASED SIGNIFICANTLY IN RECENT MONTHS. ALSO, THE GOI HAS INCREASED CREDIT TO RURAL AREAS IN AN ATTEMPT TO STIMULATE CONSUMER DEMAND THERE.

4. BOTH THE "ALL COMMODITIES" AND "FOOD" PRICE INDICES EXPERIENCED A PARTICULARLY SHARP INCREASE BEGINNING THE SECOND WEEK OF JUNE. THIS RISE HAS BEEN PRIMARILY DUE TO HIGHER PRICES OF COTTON, VEGETABLE OIL, AND SUGAR, WHOSE DEMAND HAS OUTSTRIPPED LOCAL SUPPLY. THE GOI IS EXPORTING ALL THREE COMMODITIES, PARTICULARLY SUGAR. (SOME NEWSPAPERS HAVE ATTRIBUTED THE RECENT PRICE RISES TO THESE EXPORTS, ALTHOUGH INDIA'S COTTON AND VEGETABLE OIL EXPORTS ARE RELATIVELY SMALL.) ALSO, THE ERRATIC PROGRESS OF THE MONSOON IN JUNE AROUSED MARKET CONCERN ABOUT CROP PROSPECTS LATER THIS YEAR AND MAY HAVE INDUCED SOME HOLDING BACK OF SUPPLIES, WHICH COULD HAVE RESULTED IN HIGHER PRICES OF SOME FOOD ITEMS. RENEWED MONSOON ACTIVITY OCCURRED IN THE SECOND WEEK OF JULY, AND IT IS TOO EARLY TO PREDICT HOW THE RAINS WILL ULTIMATELY AFFECT PRICES LATER THIS YEAR.

5. FINANCE MINISTER SUBRAMANIAM AND OTHER GOI ECONOMIC OFFICIALS HAVE PUBLICLY EXPRESSED CONCERN ABOUT THE PRICE RISES. THE GOVERNMENT HAS DECIDED TO IMPORT COTTON AND VEGETABLE OIL IN AN ATTEMPT TO STEM RECENT PRICE INCREASES OF THESE COMMODITIES. FURTHER REPORTED TRANSFERS OF "LEVY" (CONTROLLED PRICE) SUGAR TO THE OPEN MARKET WILL HOPEFULLY DRIVE DOWN ITS OPEN MARKET PRICE. SUBRAMANIAM HAS CALLED A MEETING OF HIGH LEVEL OFFICIALS ON JULY 16 TO WORK OUT AN ANTI-INFLATIONARY ACTION PLAN TO BE PRESENTED TO THE PRIME MINISTER. A WEATHER EXPERT HAS BEEN INCLUDED IN THE MEETING BECAUSE OF THE IMPORTANT EFFECT OF THE LIMITED OFFICIAL USE

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MONSOONS ON PRICES.

6. M. G. KAUL, HEAD OF FINANCE MINISTRY'S DEPARTMENT OF ECONOMIC AFFAIRS, TOLD THE DCM AND ECONOMIC COUNSELOR ON JULY 12 THAT THE GOI WAS KEEPING A CLOSE WATCH ON THE INFLATIONARY SITUATION. KAUL WAS WORRIED THAT THE POLITICAL LEADERS WERE FOSTERING THE BELIEF BY THE PUBLIC THAT THE INFLATION RATE COULD BE KEPT DOWN TO ZERO. HE THOUGHT THIS WAS AN UNREALISTIC GOAL

AND BELIEVED THAT AN OVERALL PRICE INCREASE THIS FISCAL YEAR OF 5-6 PERCENT WAS A HEALTHY INFLATION RATE FOR AN EXPANDING ECONOMY.

7. COMMENT: THE GOI HAS PLENTY OF FX RESERVES TO INCREASE IMPORTS OF AGRICULTURAL COMMODITIES AND INDUSTRIAL RAW MATERIALS, BUT IT WILL TAKE TIME FOR THEM TO REACH INDIAN AND HAVE ANY IMPACT ON LOCAL PRICES. THE RESERVE BANK OF INDIA IS ATTEMPTING TO RESTRICT THE GROWTH IN MONEY SUPPLY AND IS MAINTAINING A RELATIVELY TIGHT CREDIT POLICY. KAUL'S CONCERN THAT POLITICIANS WILL TRY TO HOLD THE INFLATION RATE TO THE LOWEST POSSIBLE LEVEL IS ALMOST CERTAINLY RIGHT. THE GOVERNMENT'S USE OF MONETARY AND FISCAL POLICIES TO STEM INFLATION IN THE PAST TWO YEARS HAS PROBABLY BEEN ITS MAJOR ECONOMIC SUCCESS. MRS. GANDHI IS PROUD OF THIS ACHIEVEMENT, AND SHE MAY DO HER BEST TO PREVENT INFLATIONARY PRESSURES FROM INCREASING, EVEN marginally, WHATEVER THE EFFECT MAY BE ON ECONOMIC GROWTH.  
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